Anwar et al v. Fairfield Greenwich Limited et al Doc. 183

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UNITED STATES DISTRICT COURT
SOURTHERN DISTRICT OF NEW YORK

ANWAR et al., Plaintiffs, vs. FAIRFIELD GREENWICH GROUP et al. Defendants.	09 Civ. 0118 (VM)(THK)
FAIRFIELD SENTRY LIMITED, Plaintiff, vs. FAIRFIELD GREENWICH GROUP et al. Defendants.	09 Civ. 5650 (VM)(THK)

FAIRFIELD SENTRY LIMITED'S MEMORANDUM OF LAW IN SUPPORT OF ITS MOTION TO REMAND TO STATE COURT AND TO VACATE THE CONSOLIDATION ORDER

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES ii

PRELIMINARY STATEMENT 1

STATEMENT OF THE CASE 3

ARGUMENT… 4

I. THE COURT SHOULD REMAND THE ACTION FOR LACK OF SUBJECT MATTER JURISDICTION 4

- A. FGA Bears the Burden of Proof 4
- B. This is Not a Mass Action 5
- C. CAFA'S Exclusions Also Preclude Jurisdiction 8
- D. The Company Should Be Awarded Costs 8

II. THE COURT SHOULD VACATE THE ORDER OF CONSOLIDATION 9

- A. The Standard For Consolidation 9
- B. Consolidation Would Strip the Company's Right to Prosecute Its Separate and Distinct Claims Against the Fairfield Defendants 10
- C. Consolidation Would Unduly Delay the Prosecution of the Company's Direct Claims 11

CONCLUSION 13

TABLE OF AUTHORITIES

CASES

Page

Abrams v. Donati
66 N.Y.2d. 951; 489 N.E.2d 751(1985)…………………………………………………....7

Anwar v. Fairfield Greenwich Ltd
2009 U.S. Dist. LEXIS 37077 (S.D.N.Y. 2009) ……………………………………..…....7

Blockbuster, Inc. v. Galeno
472 F.3d 53 (2d Cir. 2006) 4

Chiropractic Neurodiagnostic, P.C. v. Allstate Ins. Co.
No. 08-CV-2319, 2009 U.S. Dist. LEXIS 5822 (E.D.N.Y. 2009) ……………………..…..5

In Re Currency Conversion Fee Antitrust Litig.
2009 U.S. Dist. LEXIS 53265, (S.D.N.Y. 2009)…….…………………..………..…..……...9

Devlin v. Transportation Commc'ns Int'l Union
175 F.3d 121, (2d Cir. 1999)…………………………….…………………..……….......9,10

Federal Ins. Co. v. Tyco Int'l. Ltd.
422 F. Supp. 2d 357 (S.D.N.Y. 2006)……………….……………………...……...……..5

Garber v. Randell
477 F.2d 711 (2d Cir. 1973)…………………….……………………………………... 10

Gordon v. Elliman
306 N.Y. 456; 119 N.E.2d 331 (1953)…………………………….…………..…..…….7

Hart v. General Motors Corp.
129 A.D.2d 179; 517 N.Y.S.2d 490 (1st Dept 1987)……………………………..………..7

Johnson v. Celotex Corp.
899 F.2d 1281; 517 N.Y.S.2d 490 (2d Cir. 1990)……………...……………………….…….9

Johnson v. Manhattan Railway Co.
289 U.S. 479, 53 S. Ct. 721 (1933) ………………………………………………….….10

Katz v. Realty Equities Corp.
521 F.2d 1354, (2d Cir. 1975)…………………………………………..………………9

Lowendahl v. Balt. And Ohio R.R. Co.
247 A.D. 144; 287 N.Y.S. 62 (1st Dep't 1936)…………………………..……………...…6-7

Lupo v. Human Affairs Int'l
28 F.3d 269 (2d Cir. 1994)……………………………………………..…….……….….5

Martin v. Franklin Capital Corp.,
546 U.S. 132; 126 S. Ct. 704 (2005)…………………..…..………………..….……………9

In Re Methyl Tertiary Butyl Ether ("MTBE") Prods.
488 F.3d 112 (2d Cir. 2007)………………………………………………..….….………5

In re Morris
82 N.Y.2d 135; 623 N.E.2d 1157 (1993)……………………….……….…...……6

Palm Harbor Homes, Inc. v. Walters
No. 08-CV-196, 2009 WL 562854 (M.D. Ala. 2009) 6

Primavera Familienstiftung v. Askin,
1996 U.S. Dist. LEXIS 12683 (S.D.N.Y. 1996)…………………….……...……….…7

In re Repetitive Stress Injury Litig.
11 F.3d 368 (2d Cir. 1993)……………………………….……………….……..…….….9

Segal v. Varonis Systems, Inc.
601 F. Supp. 2d 551 (S.D.N.Y 2009)..……………..……………………….….….………..…5

Scottish Air Int'l. v. British Caledonia Group
PLC, 81 F.3d 1224 (2d Cir. 1996)…………..………………………..……….…..7

Tanoh v. Dow Chem. Co.,
561 F.3d 945 (9th Cir. 2009)……………………………………………….….….….……6

Transeastern Shipping Corp. v. India Supply Mission,
53 F.R.D. 204 (S.D.N.Y. 1971)……………………………..…………………………….9

Vaughn v. LJ International, Inc.
174 Cal. App. 4th 213; 94 Cal. Rptr. 3d 166 (Cal. Ct. App. 2009)…..…………………….….7

Webb v. Goord
197 F.R.D. 98 (S.D.N.Y. 2000)…………………………….…………………….….9,10

STATUTES AND RULES

28 U.S.C. § 1332(c)………………………………………………….…………………..6, n.4

28 U.S.C. § 1332(d)(9)(b)……..………………………………………………......................8

28 U.S.C. § 1332(d)(11)(B)(i)……………………..……………………..…………...1, 2, 6

28 U.S.C. §1447(c)…………………………………………………………...…...….......1, 4, 8

15 U.S.C. § 78u-4(b)(3)(B)………………………………………………….….............….....11

Fed. R. Civ. P. 42(a)...........………………………………………………….……..........…....9

Plaintiff Fairfield Sentry Limited (the "Company") respectfully submits this memorandum of law in support of its motion to (1) remand this action back to state court under 28 U.S.C. § 1447(c) for lack of subject matter jurisdiction, and (2) vacate the consolidation order, filed on June 25, 2009, Docket No. 177, under sections 2 and 7 of this Court's Consolidation Order and Order for Appointment, dated January 31, 2009, Docket No. 40 (hereinafter the "Standing Consolidation Order").[1]

PRELIMINARY STATEMENT

This is a straightforward case in which the Company seeks, among other things, the return of management and performance fees which it erroneously paid to its former investment and risk managers, Defendants Fairfield Greenwich Group, Fairfield International Managers, Inc., Fairfield Greenwich Limited, Fairfield Greenwich Advisors LLC and Fairfield Greenwich (Bermuda) Ltd. (the "Fairfield Entity Defendants"), based on inflated net asset value reports derived from the Company's investments with Bernard L. Madoff Investment Securities LLC ("BLMIS").[2] Fairfield Greenwich Advisors LLC's ("FGA") sole basis for removal is that this case involves a "mass action" under the Class Action Fairness Act of 2005 ("CAFA"). *See* Notice of Removal, dated June 19, 2009, ("NoR") ¶ 4. As detailed below, because CAFA is inapplicable, this Court lacks subject matter jurisdiction.

Contrary to FGA's contention, this case is not a "mass action" under 28 U.S.C § 1332(d)(11)(B)(i)("mass action" means any civil action "in which monetary relief claims of 100 or more persons are proposed to be tried jointly ...")(emphasis added). The Company is the only plaintiff in this case and it has asserted *direct* state law claims against the Fairfield Defendants for (1) breach of the investment management agreements between the Company and certain of the Fairfield Entity Defendants, (2) breach of the fiduciary duties and duties of care owed to the Company, and (3) equity arising from the Fairfield Entity Defendants' disbursement of management and performance fees to their partners and principals. There is no dispute that the Company -- and only the Company -- has privity and standing to assert these direct claims.

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[1] Unless otherwise noted, references to Docket No. are to *Anwar v. Fairfield Greenwich Group et al.*, 09-cv-0118 (hereinafter "*Anwar*").

[2] Defendants also include certain partners and principals of the Fairfield Entity Defendants, who received a portion of the management and performance fees (Defendants will be collectively referred to herein as the "Fairfield Defendants").

FGA's representation that the Company brought these claims on behalf of its shareholders is misleading and contradicted by the plain allegations of the Company's Verified Complaint.[3] NoR ¶ 6(f). This is not a derivative action brought by shareholders on behalf of the Company. Further, FGA's contention that CAFA's 100-Person requirement can be met simply because the Company has more than 100 shareholders and recoveries will be passed on to them (NoR ¶ 6(f)) is baseless. The number of individuals holding shares in the Company is irrelevant because none of them are plaintiffs in this action. FGA's tortured interpretation of a "mass action" ignores the plain language of 28 U.S.C. § 1332 (d)(11)(B)(i), invalidates a bedrock principle of corporate law that a corporation is a separate and distinct entity, and urges the Court to engage in an extraordinary expansion of the subject matter jurisdiction of the federal courts not envisioned by Congress. Under FGA's view, literally any company, public or private, with more than 100 shareholders could be deprived of its chosen forum and haled into federal court. That is not the intent of CAFA.

To the extent the Court finds that CAFA provides the Court subject matter jurisdiction over this action, deconsolidation with *Anwar* is appropriate because the Company has asserted separate and distinct claims from those asserted by the *Anwar* class action plaintiffs – who do not, and cannot, assert derivative claims on behalf of the Company. Therefore, Co-

[3] A copy of the Verified Complaint is attached as Ex. A to the NoR.

Interim Lead Counsel for the class is not competent to represent the interests of the Company as contemplated by sections 12, 14 and 15 of the Standing Consolidation Order. Further, under the current case management order and the Fed. R. Civ. P. 26(f) discovery plan filed by certain parties in *Anwar*, the Company's action may be paralyzed as the Fairfield Defendants have taken the extreme positions that no individual consolidated pleading needs to be answered, and no discovery should be taken until the Court resolves issues relating to the filing of a future Second Amended Consolidated Complaint and the resolution of a discovery stay under the Private Securities Litigation Reform Act ("PSLRA"). Such delay would be prejudicial to the Company.

STATEMENT OF THE CASE

The Company is a company duly incorporated under the International Business Companies Act of the British Virgin Islands, and its principal place of business is in the British Virgin Islands. *Verified Complaint* filed May 29, 2009 ("*Compl.*"), ¶ 12. Beginning from November 1990 through May 2009, certain of the Fairfield Entity Defendants were retained as the Company's investment and risk adviser in connection with the Company's investments with Bernard L. Madoff Investment Securities LLC ("BLMIS"). *Compl.* ¶ 3. In connection therewith, the Fairfield Entity Defendants oversaw the day-to-day investment operations of the company. *Id.* In consideration for their services, the Fairfield Entity Defendants received: (a) starting in May 2004, a fixed monthly management fee in an amount equal to 1%, per annum, of the Company's net asset value, and (b) from inception, a quarterly performance fee in an amount equal to 20% of the net appreciation of the Company's net asset value. *Id.* ¶ 4. Partners and/or controlling persons of the Fairfield Entity Defendants received a portion of the management and performance fees. *Id.* ¶¶ 19-37.

The Company's net asset value was recorded on net asset value reports (the "Net Asset Value Reports"), which were prepared under the supervision of the Fairfield Entity

Defendants based on the account statements and information that BLMIS provided to the Fairfield Entity Defendants. *Compl.* ¶ 5. On March 12, 2009, Bernard Madoff admitted that he began his fraud in the 1990s and pled guilty to 11 counts of securities fraud. *Id.* ¶ 8.

Madoff's admissions contradicted the Net Asset Value Reports. Accordingly, from the outset of its relationship with Defendants, the Company paid, and Defendants received, hundreds of millions of dollars in management and performance fees based on inflated information. *Id.* ¶ 10. The Company is entitled to recover these fees.

Procedural History

The Company's Verified Complaint was filed in the New York Supreme Court, County of New York on May 29, 2009, and it was removed by FGA to this Court on June 19, 2009. By Order dated June 25, 2009 (Docket No. 177), this action was consolidated with *Anwar* under the Standing Consolidation Order and the Civil Case Management Plan and Scheduling Order issued by this court on March 11, 2009 (Docket. No. 69) (the "CMO"). Thus, this motion is timely under Section 7 of the Standing Consolidation Order and 28 U.S.C. § 1447(c). Affidavit of Jack Yoskowitz, sworn to July 10, 2009 ("Yoskowitz Aff.") ¶¶ 2-3.

ARGUMENT

I.

THE COURT SHOULD REMAND THE ACTION FOR LACK OF SUBJECT MATTER JURISDICTION

A. FGA Bears the Burden of Proof

FGA bears the burden of establishing subject matter jurisdiction under CAFA. *Blockbuster, Inc. v. Galeno*, 472 F.3d 53, 58 (2d Cir. 2006) ("we hold that CAFA did not change the traditional rule and that defendant bears the burden of establishing federal subject matter jurisdiction"); *Anwar v. Fairfield Greenwich Ltd.*, 09 Civ 118 (VM)(THK), 2009 U.S. Dist.

LEXIS 37077, *12 (S.D.N.Y. May 1, 2009). Moreover, "when the removal of an action to federal court is contested, 'the burden falls squarely upon the removing party to establish its right to a federal forum by 'competent proof.'" *Federal Ins. Co. v. Tyco Int'l. Ltd.*, 422 F. Supp. 2d 357, 368 (S.D.N.Y. 2006)(internal citation omitted).

Federal courts construe the removal narrowly and there is a strong presumption against removal. *Lupo v. Human Affairs Int'l., Inc.*, 28 F. 3d 269, 274 n.16 (2d Cir. 1994) ("In light of the congressional intent to restrict federal jurisdiction, as well as the importance of preserving the independence of state governments, federal courts construe the removal statute narrowly, resolving any doubts against removability."); *Chiropractic Neurodiagnostic, P.C. v. Allstate Ins. Co.*, No. 08-CV-23 19, 2009 U.S. Dist. LEXIS 5822, *7-8 (E.D.N.Y. Jan. 26, 2009) (remanding case removed under CAFA, explaining that "any doubts" must be "resolved against removability 'out of respect for the limited jurisdiction of the federal courts and the rights of states.'") (quoting *In re Methyl Tertiary Butyl Ether ("MTBE") Prods.*, 488 F.3d 112, 124 (2d Cir. 2007)). *See also Segal v. Varonis Systems, Inc.*, 601 F. Supp. 2d 551, 552-53 (S.D.N.Y. 2009) ("A plaintiff is the 'master of the complaint' and may preclude removal by electing to disregard available federal dimension of a claim and asserting only a distinct state law cause of action"). FGA cannot meet its burden.

B. This is Not a "Mass Action"

FGA concedes, as it must, that this is not a "class action." NoR ¶ 4. Instead, FGA argues that this case is a "mass action" given that the Company has more than 700 shareholders, notwithstanding the undisputed fact that not one of them is a plaintiff in this case. NoR ¶ 4, 6(f). See also Ex. B to NoR. CAFA defines a "mass action" as

> any civil action ... in which *monetary relief claims of 100 or more persons are proposed to be tried jointly* on the ground that the plaintiffs' claims involve common questions of law or fact, except

> that jurisdiction shall exist only over those plaintiffs whose claims in a mass action satisfy the jurisdictional amount requirements under [section 1332](a).

28 U.S.C. § 1332(d)(11)(B)(i) (emphasis added).

From the face of the Verified Complaint it is clear that there is only *one* plaintiff, and the Company asserts claims on its own behalf. Contrary to FGA's representation (NoR ¶ 6(f)), the Company does not assert individual claims on behalf of 100 or more persons -- much less claims of 100 persons that are proposed to be tried jointly. The absence of 100 claimants in the Verified Complaint is fatal to any "mass action" jurisdiction under CAFA. *Tanoh v. Dow Chem. Co.*, 561 F.3d 945, 953 (9th Cir. 2009) (affirming remand because CAFA's "mass action" provision did not permit removal of various cases, each of which asserted claims of fewer than 100 plaintiffs). *Palm Harbor Homes, Inc. v. Walters*, No. 08-196, 2009 U.S. Dist. LEXIS 17740, *4 (M.D. Ala. Mar. 5 2009) (declining to extend jurisdiction under CAFA where, as here, the action was filed by a single corporate plaintiff).

Further, to find that the 100-person requirement is met merely because a private or public corporation has more than 100 shareholders would ignore well-settled corporate law that the corporation is a distinct legal entity separate from its shareholders.[4] It is "the accepted principle that a corporation exists independently of its owners, as a separate legal entity, that the owners are normally not liable for the debts of the corporation, and that it is perfectly legal to incorporate for the express purpose of limiting the liability of corporate owners." *In re Morris,* 82 N.Y.2d 135, 140 (1993). Corporate separateness is the principle "[a]round [which] the entire body of corporation law is built. It is accepted in theory and practice and ingrained in our legal and economic systems. Courts will not lightly disregard the corporate entity." *Lowendahl v.*

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[4] By way of analogy, for diversity purposes, a corporation is deemed to be a citizen of the State where it was incorporated or the State where it has its principal place of business. 28 U.S.C. § 1332(c). The citizenship of its non-party individual shareholders is irrelevant.

Balt. And Ohio R.R. Co., 247 A.D. 144, 154 (1st Dep't 1936). We are not aware of, and FGA has not cited to, any authority permitting the piercing of the corporate veil to count the number of *non-party* shareholders of a company to satisfy CAFA's 100-person requirement. The corporate form should be respected here.

It is also well-established that shareholders have no standing to assert individual claims predicated on mismanagement resulting in the diminution of value of their shares. Those claims belong to the corporation. *Gordon v. Elliman*, 206 N.Y. 456, 466 (1953); *Abrams v. Donati*, 66 N.Y.2d 951, 953 (1985); *Primavera Familienstiftung v. Askin*, 1996 U.S. Dist. LEXIS 12683, *42 (S.D.N.Y. 1996) ("Claims based on corporate mismanagement or third-party action that resulted in diminution of share value belong to the corporation and can only be brought by it."). Therefore, not one of the Company's shareholders has standing to assert the direct claims that the Company has asserted in the Verified Complaint.

Moreover, because the Company has taken action to recover its losses, no shareholder of the Company has standing to bring a derivative lawsuit here on behalf of the Company under British Virgin Islands law. Under the well-settled "internal affairs" doctrine, *Hart v. General Motors Corp.*, 129 A.D.2d 179, 183 (1st Dep't 1987), *Scottish Air Int'l. v. British Caledonia Group, PLC*, 81 F.2d 1224, 1234 (2d Cir. 1996), a BVI company shareholder's right to commence a derivative action is governed by British Virgin Islands law. *See e.g. Vaughn v. LJ International, Inc.*, 174 Cal. App. 4th 213 (Cal. Ct. App. 2009) (observing that the BVI Business Companies Act is the statute that specifically addresses shareholder derivative actions, and noting that Section 184C of the Act restricts derivative actions where, as here, the company has commenced proceedings to enforce its rights). No shareholder of the

Company has obtained the proper leave from a British Virgin Islands court to assert such claims.[5]

In sum, because the Company is the proper and sole plaintiff in this action, the Company's action is not a "mass action" under CAFA.

C. CAFA's Exclusions Also Preclude Jurisdiction

Remand is also proper because the Company's claims implicate its internal affairs and the duties that the Fairfield Defendants owed to the Company. CAFA provides that subject matter jurisdiction under section § 1332(d)(2) shall not apply to any class action that solely involves a claim:

> that relates to the internal affairs or governance of a corporation or other form of business enterprise and that arises under or by virtue of the laws of the State in which such corporation or business enterprise is incorporated or organized ....

28 U.S.C. § 1332(d)(9)(B).

Here, jurisdiction is precluded by 28 U.S.C. § 1332(d)(9)(B). The Company seeks to recover damages from, and the return of management and performance fees paid to, the Fairfield Defendants who were responsible for the day-to-day operations and management of the Company's investments with BLMIS.

D. The Company Should be Awarded Costs

Under 28 U.S.C. § 1447(c), the Court "may require payment of just costs and any actual expenses, including attorney fees, incurred as a result of the removal." In evaluating such relief, the Court properly considers whether the removing party "lacked an objectively reasonable basis for seeking removal." *Martin v. Franklin Capital Corp.*, 546 U.S. 132, 141 (2005). Here, there was no reasonable basis for the removal given that this action is clearly not a "class action" nor a "mass action" as those terms are defined by CAFA.

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[5] In fact, that precise issue is presently before the New York State Supreme Court. On May 15, 2009, Morning Mist Holdings Ltd. and Miguel Lomeli (the "*Morning Mist*" Plaintiffs), purported shareholders of the Company, filed a proposed derivative shareholder lawsuit on behalf of the Company. Simultaneous with that complaint, the *Morning Mist* Plaintiffs filed under a separate index number a petition seeking leave to pursue a derivative action on behalf of the Company in accordance with the laws of the British Virgin Islands. *Morning Mist Holdings Ltd. and Miguel Lomeli v. Fairfield Sentry Ltd.*, Index No. 601527/09 (Sup. Ct. N.Y. County). On July 2, 2009, the Company filed opposition papers and answered the petition.

II

THE COURT SHOULD VACATE THE ORDER OF CONSOLIDATION

The consolidation order should be vacated for two principal reasons: (a) as detailed above, the Court lacks subject matter jurisdiction, and (b) consolidation with the massive putative *Anwar* class action will cause delay, in effect merge the Company's claims with the class action plaintiffs in violation of the "no merger" rule, and prejudice the Company.

A. Standard for Consolidation

Federal Rule of Civil Procedure 42(a) empowers the Court to consolidate actions when there are common questions of law or fact to avoid unnecessary costs or delay. *Johnson v. Celotex Corp*., 899 F.2d 1281, 1284 (2d Cir. 1990). The burden is on FGA -- as the proponent for consolidation -- to demonstrate that consolidation is appropriate by showing the commonality of factual and legal issues in different actions. *Webb v. Goord*, 197 F.R.D. 98, 101 (citing *In re Repetitive Stress Injury Litig.*, 11 F.3d 368, 374 (2d Cir. 1993)); *In re Currency Conversion Fee Antitrust Litig.*, 2009 U.S. Dist. LEXIS 53265, *6 (S.D.N.Y., June 18, 2009)(citing *Transeastern Shipping Corp. v. India Supply Mission*, 53 F.R.D. 204, 206 (S.D.N.Y. 1971)).

The "district court must examine 'the special underlying facts' with 'close attention' before ordering a consolidation." *In re Repetitive Stress Injury Litig*., 11 F.3d at 374 (quoting *Katz v. Realty Equities Corp.*, 521 F.2d 1354, 1361 (2d Cir. 1975)). Moreover, the only purpose of consolidating actions is to promote judicial economy, specifically to "expedite trial and eliminate unnecessary repetition and confusion." *Devlin v. Transportation Commc'ns Int'l*

Union, 175 F.3d 121, 130 (2d Cir. 1999). Judicial economy, however, must be balanced against considerations of equity and "efficiency cannot be permitted to prevail at the expense of justice." *Devlin*, 175 F.3d at 130. Where the benefits of consolidation are outweighed by prejudice to a party, actions should not be consolidated. *Garber v. Randell*, 477 F.2d 711, 714 (2d Cir. 1973); *Webb*, 197 F.R.D. at 10.

A close look at the underlying facts and the case management orders of *Anwar* warrants that this action be deconsolidated from the *Anwar* class action.

B. Consolidation Would Strip the Company's Right to Prosecute Its Separate and Distinct Claims Against the Fairfield Defendants

It is undisputed that the Company has standing to prosecute its direct claims against the Fairfield Defendants. *See supra* at p. 7. However, the terms of the controlling case management orders in *Anwar* would in effect eliminate the Company's right to prosecute its claims in violation of the "no merger" rule. *Johnson v. Manhattan Railway Co.*, 289 U.S. 479, 496-97 (consolidation does not merge the suits into a single cause, or change the rights of the parties, or make those who are parties in one suit parties in another).

The Standing Consolidation Order appointed counsel for the *Anwar* class action plaintiffs as Interim Co-Lead Counsel to "act on behalf of all Plaintiffs in the consolidated cases." (Standing Consolidation Order ¶ 12).[6] It also provides that Interim Co-Lead Counsel "shall have sole authority" over briefing of motions, pretrial activities and plan for trial, settlement negotiations, and matters concerning the prosecution and/or resolution of the consolidated actions. *Id.* ¶ 14. On April 24, 2009, the Consolidated Amended Complaint was filed (Docket.

[6] The Company notes that the CMO and the Standing Consolidation Order are a product of negotiations between counsel for the *Anwar* class action plaintiffs and counsel for certain of the defendants, which occurred before the Company was consolidated in *Anwar* as a plaintiff.

No. 116) asserting direct claims of shareholders against entities and individuals related to Fairfield Greenwich Group, and entities related to Citco Fund Services (Europe) B.V.

The Consolidated Amended Complaint does not, and cannot, purport to assert derivative claims on behalf of the Company.[7] Nor do the *Anwar* class action plaintiffs, or any other shareholder of the Company for that matter, have standing to pursue a derivative action on behalf of the Company under British Virgin Islands law. *See, supra*, p. 7.

Therefore, the Company has asserted direct claims against the Fairfield Defendants, which are separate and distinct from the claims asserted by the class action plaintiffs. To be sure, no purported shareholder of the Company (nor its counsel) is competent to act on behalf of the Company in the consolidated actions.

C. Consolidation Would Unduly Delay the Prosecution of the Company's Direct Claims

On May 29, 2009, a Joint Rule 26(f) Discovery Plan was filed, which stated that Interim Co-Lead Plaintiff would seek leave to file a Second Consolidated Amended Complaint to include claims under the federal securities law claims under the PLSRA, which imposes a stay of discovery while a motion to dismiss is pending. Specifically, the statute states, "in any private action arising under [federal securities law], all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party." 15 U.S.C. § 78u-4(b)(3)(B). By Order dated July 7, 2009 (Docket. No.

[7] By notice of removal dated May 28, 2009, FGA removed a proposed shareholder derivative action on behalf of the Company to this Court. *Morning Mist Holdings, Ltd. v. Fairfield Greenwich Group, et al.*, 09 Civ 5012, Docket No. 1. On June 8, 2009, the Morning Mist Plaintiffs moved to remand this action to state court. *Id.* Docket No. 9. On June 9, 2009, the proposed shareholder derivative action was consolidated with *Anwar*. *Id.* Docket No. 11. On June 24, 2009, the *Morning Mist* Plaintiffs moved to vacate the consolidation order and to appoint their counsel as Co-Lead Derivative Counsel in *Anwar*. *Id.*, Docket No. 13. The Company objects to any appointment of Co-Lead Derivative Counsel as premature given that the issue is pending before the New York State Supreme Court.

178) the Court appointed counsel for the *Anwar* plaintiffs as lead plaintiffs given that they plan to file a second amended consolidated complaint to include PSLRA claims and to "vigorously" pursue those claims. See also Stipulation Adjourning Deadline to Respond to the Complaint, dated June 9, 2009 (Docket No. 168).

Further, under the CMO, the Fairfield Defendants apparently are only obliged to respond or answer to the Amended Consolidated Complaint, and not to any individual complaints. CMO Section 6 states "Defendants shall respond *only* to the Consolidated Amended Complaint; no response is due to any *individual complaints that are consolidated* into the Consolidated Action." (emphasis added). Thus, the Company will be further prejudiced by consolidation because the Fairfield Defendants have taken the position that they have no obligation to answer individual complaints under the CMO. *See* Yoskowitz Aff. Ex. A (Mark Cunha's June 9, 2009 letter to the Court).

In addition, the Discovery Plan contemplates a stay of discovery pending the resolution of issues relating to the PSLRA stay. While the PSLRA stay should not apply to the Company's action as it involves state law claims and does not implicate state or federal securities law claims, it appears that the Fairfield Defendants would nonetheless seek to stay discovery under the Discovery Plan, and further delay the prosecution of the Company's claims.

CONCLUSION

For the foregoing reasons, the Company's motion should be granted and costs should be awarded to the Company.

New York, New York
July 10, 2009

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